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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant,

vs.

G. D. BAIR, DIRECTOR OF REVENUE,
STATE OF IOWA,
Appellee.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF IOWA

BRIEF FOR THE APPELLANT

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MOORMAN MANUFACTURING COMPANY,
Appellant,

vs.

G. D. BAIR, DIRECTOR OF REVENUE,
STATE OF IOWA,
Appellee.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF IOWA

BRIEF FOR THE APPELLANT

Moorman Manufacturing Company appeals from the final judgment of the Supreme Court of Iowa reversing the decision of the trial court and confirming an assessment of additional income tax measured by the difference between income apportionment according to the standard three-factor formula and attribution of income entirely to the situs of customers.

OPINIONS BELOW

The opinion and order of the Iowa Director of Revenue dated December 17, 1974, is unreported (A. 2). The Findings of Fact and Conclusions of Law of the District Court of the State of Iowa in and for Polk County, Equity No. CE 3-1595, filed December 17, 1976, the revision thereof filed January 7, 1977 (entitled Ruling on Joint Motion

to Reconsider and Supplemental Findings), and that Court's Judgment and Decree are unreported (A. 56). The opinion and judgment of the Supreme Court of Iowa entered May 25, 1977, is reported at 254 N.W.2d 737 (Iowa, 1977). Copies of that opinion and the unreported order denying rehearing entered June 27, 1977 are in the Appendix (A. 103).

JURISDICTION

The judgment of the Supreme Court of Iowa became final with the entry on June 27, 1977 of the order denying rehearing. The jurisdictional statement was filed September 22, 1977 and probable jurisdiction was noted November 14, 1977, 46 U.S.L. Week 3317 (U.S. Nov. 14, 1977). The jurisdiction of this Court is conferred by 62 Stat. 929, 28 USC 1257(2), the issue being a state statute unconstitutional on its face and so applied as to burden unduly Moorman's interstate commerce, to deprive it of property without due process of law and to deny it equal protection of the laws, contrary to Art. I, Sec. 8, Cl. 3 of the Constitution of the United States relating to interstate commerce and to the due process and equal protection guaranties of the Fourteenth Amendment thereto.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Art. I, Sec. 8, Cl. 3 of the Constitution of the United States and the Due Process and Equal Protection Clauses of the Fourteenth Amendment thereto are set forth in Appendix A, p. A1, *infra*.

The pertinent sections of the Code of Iowa, being Sections 422.33 and 422.35 contained in Volume II pages

1669 and 1670, Code of Iowa (1966) are set forth verbatim in Appendix B, pp. A1-A5, *infra*.

The pertinent section of the Illinois Income Tax Act, being 120 Ill. Rev. Stat. §3-304(a), is set forth verbatim in Appendix C, pp. A5-A6, *infra*.

The pertinent sections of the Uniform Division of Income for Tax Purposes Act §§3, 9, are set forth verbatim in Appendix D, p. A6, *infra*.

QUESTIONS PRESENTED[1]

Interstate Commerce, Due Process, Territorial Jurisdiction and Equal Protection

Whether the single-factor destination sales formula for the "apportionment" of net income, prescribed by the Iowa income tax statute, is invalid:

(a) as repugnant to the Commerce Clause of the Constitution;

(b) as repugnant to the Due Process Clause of the Fourteenth Amendment to the Constitution;

(c) as unconstitutionally extending the power of the State beyond its territorial jurisdiction;

(d) as repugnant to the Equal Protection Clause of the Fourteenth Amendment to the Constitution;

when the application of such formula results in the taxation by Iowa of 100% of the net income of a foreign corporation derived from that segment of its business consisting of the manufacture of products without Iowa and their sale to customers within Iowa, while a domestic

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1. Reprinted verbatim from Jurisdictional Statement.

corporation pays no Iowa income tax with respect to its exports, thus

(1) discriminating against interstate commerce by imposing upon it cumulative tax burdens (double taxation) to which local commerce is not subject;

(2) subjecting to Iowa tax an amount of income out of all reasonable proportion to the business actually done within Iowa;

(3) taxing extra-territorial values and assigning to Iowa values which belong to, and have been properly taxed by, another state (Illinois); and

(4) subsidizing exports and imposing a tariff on imports.

STATEMENT OF THE CASE

The operative facts were fully stipulated (A. 20), the sole issue on appeal being the constitutionality of the Iowa statute applied to those facts.

Moorman Manufacturing Company is an Illinois corporation headquartered in Quincy, Illinois. Its business is the manufacture of animal feeds which it sells to farmers and others in thirty states, including Iowa. During the years at issue, all goods sold to Iowa customers were manufactured in Illinois and no manufacturing was done in Iowa. Orders are solicited from Iowa customers by a substantial force of resident salesmen and typically are filled from stocks in warehouses in Iowa to which they have been shipped from factories in Illinois.[2]

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2. Moorman also made sales in Illinois which were delivered to Iowa. These were treated as Iowa sales under the statute in effect during the last year at issue and included in the controverted assessment (A. 3).

Appellant brought proceedings before the Iowa Director of Revenue for review of income tax deficiencies for the taxable years 1968 through 1972 assessed by him pursuant to the income tax section (Sec. 422.33) of the Code of Iowa. The Director affirmed the assessments. Moorman then appealed to the District Court, where there was trial *de novo*. The District Court found the statutory "apportionment" formula "facially unconstitutional" and struck most of the assessments (all that are involved in this Appeal). The Supreme Court of Iowa reversed the District Court and reinstated the assessments.

The assessments under Appeal are the differences between what Moorman paid, following the three-factor formula of the Uniform Division of Income for Tax Purposes Act, and the amounts asserted by the Director following the Iowa statutory single-factor formula of sales attributed to destination. The assessments tax 100% of Moorman's income from that segment of its business which consists of manufacturing goods in Illinois and selling them to customers in Iowa, taking no account of the contribution of capital and labor to the production of income.

The District Court found as *facts*: The Iowa single-factor formula taxed 100% of the income from each dollar of sales of Moorman's goods into Iowa, although 75% of payroll and 30% of capital are used in the manufacture of the goods (in Illinois) (A. 76); the Iowa formula fails to reasonably apportion profits traceable to Illinois and taxes activities occurring in Illinois (A. 77); the Iowa formula produces multiple taxation of the same income (A. 86); Illinois taxed the relevant income by the three-factor formula (A. 81); the Iowa formula taxed values beyond those which may be justly allocated to intrastate activity, and resulted in "gross overreaching" by the State

(A. 81); for 1968, the Iowa and Illinois formulae taken together "apportioned" 141.76% of Moorman's income from its Iowa sales (A. 84); Iowa is the only state attributing income to sales alone (A. 85); the interplay of the Iowa and Illinois formulae would give unfair advantage to an Iowa manufacturer selling in Illinois in that only one-third of the relevant income would be taxed (A. 86).

While Iowa was thus assessing 100% of the income arising from manufacture in Illinois and sale to Iowa customers pursuant to its destination-sales-only formula, Illinois was applying its three-factor formula of property, payroll and sales, equally weighted, to Moorman's net income for the same years (1970-1972). Since all manufacturing took place in Illinois, the property and payroll factors attributed to Illinois substantial parts of the same income that Iowa attributed entirely to itself—a clear case of double taxation.

The District Court held, on the basis of those findings, that Iowa's single-factor formula violated the Commerce and Due Process provisions of the United States Constitution, and cancelled the assessments (A. 40, 41). Upon appeal, the Supreme Court of Iowa reversed.

The Iowa Supreme Court's opinion makes much of the point that an apportionment formula cannot be precise and hence approximation is all that is required (A. 130). It asserts that a number of decisions of this Court approve single-factor formulae, without noting that none of them was anything like *this* single-factor formula (A. 124). It quotes extensively from *General Motors Corporation* v. *District of Columbia,* 380 U.S. 553 (1965), but dismisses that case as a statutory, rather than a constitutional, decision (A. 128), incidentally pointing out that the Iowa statute contains no provision that income from interstate

commerce shall be "deemed to" arise in both states (as the D. C. statute does), and says there is no due process requirement for such "deeming" (A. 130).

It asserts that evidence does not establish either double taxation or taxation of extra-territorial values—ignoring the findings of fact (A. 132). It denies that the assessments tax 100% of Moorman's income from Iowa sales because of statutory adjustments to the income *base* —thus relying upon an aspect of the tax law wholly irrelevant to apportionment, to conclude that Moorman had not show that its income from Iowa sales had been taxed more than 100%, again ignoring the findings of fact (A. 134).

The assessments were on a basis identical to that declared invalid in *General Motors Corporation* v. *District of Columbia, supra.* It was stipulated by the parties that if that basis is unconstitutional, the appropriate basis is the Uniform Act by which Moorman paid initially (A. 31).

The constitutional questions were presented and vigorously argued, both orally and in writing, at every opportunity and were considered by each of the three tribunals: the administrative proceeding, the district court in the trial *de novo,* and the Iowa Supreme Court, as shown by their respective opinions (A. 2, 56, 103). The questions raised, in each case contending invalidity under the pertinent provisions of the United States Constitution, of the statute both on its face and as applied, were: denial of equal protection; denial of due process; and undue burden on interstate commerce.

SUMMARY OF ARGUMENT

1. When two jurisdictions use overlapping formulae for the attribution of income for tax purposes, double taxation inevitably results, in violation of the Commerce Clause of the Constitution. When one of the jurisdictions applies the standard three-factor formula, the double taxation is the fault of the other jurisdiction.

2. The purpose and effect of the sales factor is to subsidize exports and impose a tariff on imports. It does not apportion income, but merely identifies the total income from the relevant segment of the business. When such income is derived in substantial part from activities outside the jurisdiction, the effect is to project the jurisdiction's reach beyond its geographical limits in violation of the Due Process Clause of the Constitution and in defiance of a fundamental principle of federalism.

3. The effect of the interplay of Iowa's sales-only formula with the three-factor formula used by other states, including Illinois, is to provide benefits to Iowa-based business unavailable to other business and hence deprives such other business, including Moorman, of its constitutional right to Equal Protection.

4. Even if it were not invalid on its face, the Iowa formula is invalid as applied to Moorman.

5. The economic impact of the Iowa decision, if allowed to stand, will be severe and will go a long way toward weakening the common market intended by the Constitution.

ARGUMENT

I. Double Taxation and Discrimination Against Interstate Commerce Violate the Commerce Clause.

> "The great majority of States imposing corporate income taxes apportion the total income of a corporation by application of a three-factor formula which gives equal weight to the geographical distribution of plant, payroll and sales. The use of an apportionment formula based wholly on the sales factor, in the context of general use of the three-factor approach, will ordinarily result in multiple taxation of corporate net income; for the States in which the property and payroll of the corporation are located will allocate to themselves 67% of the corporation's income, whereas the jurisdictions in which sales are made will allocate 100% of the income to themselves." *General Motors Corporation* v. *District of Columbia*, 380 U.S. 553 (1965), at 559.

The commerce clause (Article I, Section 8, Clause 3) of the United States Constitution prohibits a state from imposing a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business or by subjecting interstate commerce to the risk of multiple taxation. *J.D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307 (1938); *Gwin, White & Prince* v. *Henneford*, 305 U.S. 434 (1939); *Evco* v. *Jones*, 409 U.S. 91 (1972). The Court recently emphatically and unanimously reaffirmed the commerce clause prohibition against tax discrimination in favor of home based businesses in *Boston Stock Exchange* v. *State Tax Commission*, 429 U.S. 318 (1977):

"Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects."

All the income of a corporation, including that generated by interstate commerce, may be taxed (cumulatively) by the several states, but such income is not to be taxed twice. It is beyond question that a state in which a product is manufactured has the right to tax income arising from that product, even though it is sold in another state. This is true for at least two reasons:

1. The property (plant, equipment, raw materials, etc.) and people (employees) involved in the manufacture of the product are obviously part of the income-producing process; and

2. The state of manufacture renders services to the property and people involved in the manufacturing process.

Where, however, the state in which the sale occurs (Iowa) taxes *all* the income arising from the manufacture and sale, the taxpayer is subject to the risk of being taxed on more than 100% of the income, since the state of manufacture is likewise entitled to tax at least part of the income.

In this case, the overlap is less than the 67% noted by this Court in *General Motors* because Moorman has property and payroll in Iowa, and those amounts are excluded from the property and payroll which Illinois attributes to itself. In each of the five years in issue there is, however, very substantial overlap.

By applying the Iowa formula to Moorman's total apportionable income, the Director has determined the amount of Moorman's total net income resulting from the manufacture and sale of its products to Iowa customers. Pursuant to the Iowa single sales factor formula, all of the above income is taxed by the State of Iowa. However, since all the products sold in Iowa are produced in Illinois, that state is also entitled to tax the income resulting from sales in Iowa and in fact does so. Illinois uses an equally-weighted three-factor (payroll, property and sales) formula of apportionment. Illinois Income Tax Act, 120 Ill. Rev. Stat. §3-304(a) (App. C, pp. A5-A6). Pursuant to that (customary) formula, the Illinois property and payroll factors are determined by comparing property and payroll in Illinois with property and payroll everywhere. The sales factor in a three-factor formula such as that used by Illinois, relates principally to sales made in the taxing state (here, Illinois). Since we are concerned solely with the income arising from sales in Iowa, the sales factor in the Illinois formula will be zero.

Thus, the State of Illinois would tax income arising from sales in Iowa based upon the following percentages as determined above:

	FYE 3-31-68	FYE 3-31-69	FYE 3-31-70	FYE 3-31-71	FYE 3-31-72
Sales Factor (Sales in Iowa)	–0–	–0–	–0–	–0–	–0–
Payroll[3] Factor	41.00%	40.78%	41.16%	40.85%	40.87%
Property[4] Factor	84.29%	83.80%	61.99%	62.68%	70.15%
Total	125.29%	124.58%	103.15%	103.53%	111.02%
Average (Total ÷ 3)	41.76%	41.53%	34.38%	34.51%	37.01%

The "average" figure shown immediately above is the percentage of income arising from sales in Iowa that the state of Illinois would tax pursuant to its three-factor formula.

The total income derived from the manufacture and sale of goods to Iowa customers, as determined by the Director, is shown in the first line of the following tabulation.[5] Since Iowa taxes all of that, while Illinois taxes the shown percentages of the same income, the following degrees of overlap are established:

3. See Exhibit 15 to the Stipulation (A. 54).
4. See Exhibit 16 to the Stipulation (A. 54).
5. See Exhibit 8 to the Stipulation (A. 33).

	FYE 3-31-68	FYE 3-31-69	FYE 3-31-70	FYE 3-31-71	FYE 3-31-72
Income From Iowa Sales	$1,548,284	$1,632,469	$1,796,769	$1,837,533	$1,842,615
Total % Subject To Tax	141.76%	141.53%	134.38%	134.51%	137.01%
Total *amount* subject to tax	$2,194,847	$2,310,433	$2,414,498	$2,471,666	$2,524,567

This resulted in actual double taxation to the extent of $617,729 income in 1970, $634,133 in 1971 and $681,952 in 1972. Moorman's income from sales to Iowa customers in 1968 and 1969 was taxed 100% by Iowa but was not taxed by Illinois, which had no income tax in those years. However, Illinois could have taxed such income, as it did in the later years, and Iowa therefore exposed Moorman to the *risk* of double taxation which is enough to violate the Commerce Clause, it being irrelevant that Illinois did not choose to exert its full power of taxation.[6] *Gwin, White & Prince* v. *Henneford*, 305 U.S. 434 (1939); *J. D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307 (1938); *Evco* v. *Jones*, 409 U.S. 91 (1972).

The Iowa Court denies that Iowa taxes 100% of the income because deductions from gross income are allowed

6. This principle is recognized in the Uniform Division of Income for Tax Purposes Act, which assigns sales to destination in any jurisdiction in which the taxpayer is "taxable", without regard to whether it is in fact taxed (App. D, p. A6).

in computing net income. That argument is wholly specious, since neither base nor rate, although related to each other, has anything to do with apportionment. First the taxable income (the base) is determined according to statutory definition—gross, net, something between,—then the portion arising in the jurisdiction is found, and then the rate is applied to that portion. Base and rate are reciprocals. If there is a large base, such as gross receipts, the rate is usually low; if there is a small base, such as narrowly defined net income, the rate is apt to be high (in this case, 8% to 10%). But the definition of taxable income has no bearing whatever on what part of it belongs to what state. Iowa has taxed 100% of Moorman's relevant income as the Iowa statute defines "income". The fact that the definition is narrow and might have been broader is wholly irrelevant. It might have some relevance to an argument about rate, but there is no such question here, the sole issue being location.

The Iowa court says that since Iowa allows a deduction for 50% of the federal income tax, the formula does not tax all the taxable income. This is an obvious non sequitur. The Iowa statute divides *net* income. The legislature defines "net income" as it sees fit, subject to constitutional limitations, and varies the deductions allowable from time to time. (§422.35). For example, prior to 1967, the state allowed corporations a deduction for 100% of their federal income tax liability. (§422.35(4), Code of Iowa). If the Iowa court's reasoning is correct, the validity of the formula changes as allowable deductions change. Following this argument logically, if the formula were valid when 100% of federal income tax was an allowable deduction in Iowa, it would have been less valid or invalid when such deduction was reduced to 50% of the federal income tax and would be rendered invalid if the legislature should eliminate all deduction for federal income tax.

Likewise, assume a corporation with net income for federal tax purposes but no federal income tax liability because of allowable credits against tax, such as the investment credit or foreign tax credit. Is the Iowa apportionment formula invalid as to this corporation because it receives no federal tax deduction in computing its net income for Iowa purposes yet valid as to other corporations with a federal tax liability?

Finally, it must be remembered that *all* corporations, both foreign and Iowa, are allowed this deduction—it is not limited merely to non-Iowa based taxpayers.

The foregoing irrefutably demonstrates that tax base (net income) and the method of apportionment are separate and independent factors. There is absolutely no logical or legally acceptable reason for justifying an apportionment formula by reference to the tax base. Consequently, the risk of double taxation does exist under the Iowa formula, double taxation actually occurred, and the formula is thus violative of the Commerce Clause.

The purpose and effect of a "destination sales factor" is to subsidize exports and impose a tariff on imports. It does not "apportion" income, but merely identifies the income from that segment of the business which consists of manufacturing in one jurisdiction and selling to customers in another.

Relying on it alone, while other states use the standard formula, results in discrimination against interstate commerce. The Iowa statute serves to grant Iowa-based manufacturers a substantial advantage against competition from out-of-state manufacturers by increasing the latter's costs through subjecting them to multiple taxation. As shown previously in this brief, Moorman would be taxed on approximately 137% of its income from Iowa sales

during its fiscal year ended March 31, 1972, because of the single sales factor formula. However, any competitor of Moorman's which manufactures its products in Iowa would be subject to tax on only 100% of its income arising from Iowa sales. Thus, Moorman is at an immediate disadvantage in this situation solely by reason of the Iowa formula.

It has frequently been said, as the Director of Revenue said in this case, that "the use of formulae by other states where the taxpayer does business is not relevant." (A. 7). The thread of that argument is that we do it our way, they do it their way, and it doesn't matter that the taxpayer is squeezed; besides, our way is the right way and any unfairness is the fault of the other fellow.

This Court holds otherwise. It has frequently stated that double taxation puts an unconstitutional burden on interstate commerce and has acted to prevent it. In doing so, it has necessarily determined which jurisdiction was offending. While *General Motors, supra,* is the most pertinent of such decisions, there are others: e.g., *Freeman* v. *Hewit,* 329 U.S. 249 (1946); *Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U.S. 157, 170 (1954); *Gwin, White & Prince* v. *Henneford,* 305 U.S. 434 (1939).

As indicated in the above quotation from *General Motors,* since almost all other states use the three-factor formula the responsibility for the double taxation is Iowa's. The reason, of course, is that the Iowa formula gives no credit to the contributions of capital and labor whereas other jurisdictions do. Therefore, Iowa's single factor sales formula imposes an unconstitutional discrimination on interstate commerce.

In considering these matters of double taxation of and discrimination against interstate commerce it is well to

keep in mind the reason for the Commerce Clause in the Constitution:

> ". . . every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality. . . ." *H. P. Hood & Sons* v. *Dumond,* 336 U.S. 525, 538, 539 (1949). Quoted with approval in *Hughes* v. *Alexandria Scrap Corp.,* 426 U.S. 794, 808 (1976).

II. The Sales Factor Is Illegitimate As a Violation of Due Process and the Principle of Federalism.

The only rationale for taxes is governmental services, and in the case of business taxes the services to business, including such things as police and fire protection, roads and similar facilities, schools and others. *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959). Business taxes should therefore be paid to the jurisdictions which provide those services to the particular business paying the taxes. Property taxes, for example, do just that. So do, though less clearly, payroll taxes. It is difficult on the basis of social costs to rationalize business income taxes—the losing business imposes just as much burden on governmental facilities as does the profitable one. Business income taxes must be accepted, but in determining to what jurisdictions they are to be paid the fundamental justification for any tax must be given effect.

The jurisdictions which have rendered services to a multistate business are all of them in which it carries on business; and the degree of such services in each jurisdiction is proportional to the business activity. Police and fire protection relate to property; schools and hospitals relate to employees. So if relative quantities of property and employees are measured, and that relationship applied to tax base, the taxes are apportioned according to the grounds for their justification: governmental services. The location of the business's customers, as such, is completely irrelevant.

Current fiscal thinking by most states, however, disregards the relationship between governmental services and payment (taxes) therefor. It is this disregard which supports business income taxes. Nevertheless, the logical assignment to the various jurisdictions is the same; because income, and hence income taxes, must economically, fiscally, and constitutionally be attributed to the jurisdictions in which it arises. And these are the same jurisdictions in which governmental services are rendered, because the same factors which entail governmental costs produce business income: property and people. Thus, by measuring relative quantities of property and people in various locations we determine, in addition to relative quantities of governmental services, relative quantities of production of income. Again, the location of a business's customers is irrelevant.

As pointed out above, the purpose and effect of a "destination sales factor" is to subsidize exports and impose a tariff on imports. It does not "apportion" income, but merely identifies the income from that segment of the business which consists of manufacturing in one jurisdiction and selling to customers in another.

Even in its earliest developments, the sales factor didn't make much sense. The earliest business income taxes were apportioned on the basis of location of property. *Underwood Typewriter Company* v. *Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924); *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931); *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642 (1934). Except in the exceptional circumstances of *Hans Rees'*, acceptable results were achieved.

Later payroll was added as an additional consideration. It didn't greatly affect the result, because to a considerable extent property and payroll tend to locate together. Not entirely, however, as for example a labor-intensive branch of a manufacturing business may have considerable payroll but very little property. The addition of the payroll factor was therefore an improvement in the measurement of income-producing activity.

Massachusetts added a "sales" factor, initiating what was long called "the Massachusetts formula". It was a three-factor formula, equally weighted, of property, payroll and sales—*with sales assigned to the point of shipment.* Somewhat later, various jurisdictions began to attribute sales, not to the points of shipment, but to the locations of sales offices: "sales through offices". This, of course, greatly exaggerated the income-producing importance of those offices, since their property and payroll were already included in the apportionment numerators, but it at least attributed income to something done by the taxpayer.

Finally, and quite recently, we arrived at the attribution of sales to the location of the customer: "destination sales". This scheme was developed in industrial, high-tax states (such as Michigan) to subsidize exports into lower-tax states.

Whatever respectability, if any, may be attributed to the "destination sales factor" as a subsidy for exports is wiped out when the reverse of the coin is examined: a tariff on imports. That is its purpose and effect, unconstitutional, at least when not modified by other factors. It is the desire of Iowa to make it easy for Iowa producers to compete in foreign markets by relieving them of all income tax on such business; and to handicap foreign producers by making them pay tax on 100% of their income from Iowa business already heavily, and properly, taxed in other states.

In the first section of this argument, we pointed out that such a program imposes an unconstitutional burden on interstate commerce. It is unconstitutional for other reasons. Due process, as applied to questions of state taxation of income, requires that a state refrain from taxing substantial income-producing activities occurring outside the state. A state income tax may be levied only on that portion of a taxpayer's net income which arises from its activities within the taxing state. *Wallace* v. *Hines*, 253 U.S. 66, 70 (1920); *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 135 (1931). But the "Due Process Clause", although convenient and customarily relied upon by courts, including this one, is not needed for that purpose. It is a fundamental principle of federalism that the legal, including tax, jurisdiction of a state is confined to its geographical jurisdiction. *New York, Lake Erie & Western R.R. Co.* v. *Pennsylvania*, 153 U.S. 628 (1894). It is perfectly clear that, as the trial court found, Iowa's assessments take in income attributable to Illinois and not Iowa.

Long ago this Court recognized that "income is the product of capital or labor or both combined"—no mention of customers or their location. *Stratton's Independence,*

Ltd. v. *Howbert*, 231 U.S. 399 (1913); *Eisner* v. *Macomber*, 252 U.S. 189 (1920); and *General Motors, supra*:

> "The standard three-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates. By contrast, the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor." 380 U.S. at 561.

On its face, the single sales factor formula violates the due process clause of the Fourteenth Amendment and a basic principle of federalism in that it attempts to tax *all* the income arising from sales of tangible personal property in Iowa even though the product is manufactured outside that state. This is a patently unconstitutional approach to taxation of multistate corporations because it is indisputable that production of a product contributes a substantial part of the profit arising when it is sold:

> ". . . the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." *Hans Rees', supra*, 282 U.S. at 133.

There is no accounting recognition of income until a product is sold. But it is likewise true that no product can be sold unless it is produced. The sale merely informs us when income is realized, not what gave rise to it. By attempting to tax all the income, the single sales factor formula takes no cognizance of the contribution which the creation of the product outside the state makes to the realization of income.

Furthermore, while the State of Iowa does render services to Moorman's business in that state, it is likewise

beyond question that Illinois, in which the corporation manufactures the products which it sells to Iowa customers, also renders services to such manufacturing. The Iowa formula refuses to recognize this obvious fact and, in so doing, taxes Moorman on an excessive amount of its income, including income which belongs to Illinois, in violation of the due process clause.

The district court found as a *fact* that the income which Iowa taxed in its entirety was ". . . to a greatest degree attributable to Illinois plant and personnel inputs" (A. 76) and further found as a *fact* that the amount of income so assessed was out of all reasonable proportion to the business done in Iowa (A. 77).

The Supreme Court of Iowa made no direct response to the findings of the district court, but repeated the oft-quoted language from *Wisconsin* v. *J.C. Penney,* 311 U.S. 435 (1940):

> "The Constitution is not a formulary. It does not demand of states observance of rigid categories nor precision of technical phrasing in their exercise of the most basic power of government, that of taxation. For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society. . . The simple, but controlling question is whether the state has given anything for which it can ask return."

The Iowa Court then went on to hold that the Iowa formula

> ". . . is fairly calculated to assign to Iowa only that portion of the taxpayer's net income reasonably attributable to the trade or business done in Iowa since the taxing power exerted by the statute bears fiscal relation to the protection, opportunities and benefits given by the state." (A. 130).

There probably is no other passage in Supreme Court reports that is so often misapplied as Justice Frankfurter's felicitous phrases. There was in that case no quarrel with the apportionment formula. The issue was whether the "privilege dividend tax" was an additional income tax, and hence constitutional, or a tax on the "privilege" of paying dividends, which could not constitutionally be applied to Penney since all matters connected with dividends occurred in New York. The Wisconsin Supreme Court had said the tax was not an income tax. Justice Frankfurter and four other justices held that it was an income tax, and the quoted language tells why "practical operation" prevails over "technical phrasing."[7] Four justices dissented on the ground it was not an income tax in practical operation. In that same opinion, Justice Frankfurter warned against relying on "Ambiguous intimations of general phrases in opinions torn from the significance of concrete circumstances. . ." The principal quotation was apt in the "concrete circumstances" of *Penney* but is meaningless in *Moorman.*

"The question" remains "simple", but it definitely is not "controlling" here. In the context of this case, in which the only issue is how much tax, not "whether", the Iowa court's language quoted above is an obvious non

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7. We wonder if much of the misuse of Justice Frankfurter's opinion could have been avoided had he said—as we think he clearly meant—"in *proportion* to opportunities" instead of "in relation to opportunities".

sequitur. It says the "apportionment" is fair merely because Moorman is taxable.

The district court recognized the distinction (A. 74):

> The more narrow question presented, however, acknowledging that ". . . the tax in practical operation has relation to opportunities benefits [and] protection conferred or afforded by [Iowa is whether] the tax is fairly apportioned to the commerce carried on within [this State]." *Norfolk & Western Railway Co.* v. *Missouri State Tax Commission*, 390 U.S. 317, 325 (1968) (fn. 5).

The Supreme Court of Iowa then cited the following five decisions of this Court to support its finding: *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924); *National Leather Co.* v. *Massachusetts*, 277 U.S. 413 (1928); *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642 (1934), *aff'g per curiam* 204 N.C. 365, 168 S.E. 397 (1933); *Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331 (1939), on the theory that this Court had placed its imprimatur on *any* single factor method of apportionment. This is the same fundamental error in reasoning made by the Court of Appeals in *General Motors* v. *District of Columbia, supra* (see 336 F.2d at 897).

Moorman's position is that the five above-cited cases provide no support for the Iowa court's inference but, indeed, that the relevant ones disprove its hypothesis and support the trial court's decision.

The *Ford* case is irrelevant because it does not deal with a tax on or measured by net income but rather is an excise based on the value of the corporation's assets employed in the state, which is quite distinct from an income tax. That case involved the Texas franchise tax,

which is an excise on the corporate privilege of doing intra-state business. *National Leather* involved a similar Massachusetts tax. Such franchise taxes are fairly common and the State of Iowa imposes such a tax on both domestic and foreign corporations (§496A.126 and §496A.-127, Code of Iowa).

Of the remaining three cases, *Underwood, Kent-Coffey,* and *Bass* dealt with statutes imposing taxes on or measured by net income, wherein the apportionment formula was a single property factor. The types of apportionment formulae in those cases are, on their face, sound, in that they are reasonably proportionally related to the sources of the taxpayer's income and the social costs which it generates.

Since "income is the product of capital or labor or both combined", property (capital) in a jurisdiction is a reasonable measure of income produced there. That is wholly incompatible with destination sales (location of customers) standing alone since location of customers does not indicate location of either business activity or governmental services. In *Underwood,* the Court rejected the taxpayer's argument in effect for consideration of sales.

In 1965, this Court had occasion to review the validity of a formula identical to that contained in the Iowa statute. *General Motors Corporation* v. *District of Columbia, supra.*

In that case, the District of Columbia Income and Franchise Tax Act of 1947 provided that

> (t)he measure of the franchise tax shall be that portion of the net income of the corporation . . . as is fairly attributable to any trade or business carried on or engaged in within the District . . . . (380 U.S. at 554).

That act provided that the District Tax Commissioners were to prescribe regulations to determine the portion of income "fairly attributable" to the District. The District Tax Commissioners adopted the following regulation:

> Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. (380 U.S. at 555).

The Court of Appeals found that *only* a *single* division of G.M.'s *total* income was required. That is, by multiplying G.M.'s entire net income by the single sales factor, that portion taxable in the District of Columbia could be determined.

The appeals court rejected the taxpayer's argument that this so-called "apportionment" of G.M.'s income was not an apportionment at all, but merely determined the portion of the taxpayer's income derived from manufacture outside the District and sales in the District.

This Court repudiated the Court of Appeals reasoning by stating that an apportionment formula must "take account of the geographic spread of the major dimensions of a business" (380 U.S. at 558, fn. 8) and found that "The standard three-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates." With respect to the single sales factor method the Court said: "By contrast, the geographical distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor." (380 U.S. at 561).

The Iowa court, while skirting the point so far as direct statement is concerned, falls into the same fallacy as did the Court of Appeals in *General Motors*: it assumes that because Moorman's income from business wholly unrelated to Iowa—e.g., goods manufactured in Texas and sold to Texas customers—is not taxed by Iowa, there has been an "apportionment" of Moorman's *entire* income and therefore no further apportionment is required.

What the Iowa court overlooks is that the "reasonably attributable" division of income can be achieved *either* by finding the amount of income related to "Iowa sales" and apportioning that amount, *or* by apportioning entire net income, *and under any true apportionment formula the result will be exactly the same.*

In Appendix E hereto, beginning at p. A6, we set forth a tabulation, using Moorman's actual figures, demonstrating conclusively why the theory—that excluding wholly unrelated business is "apportionment"—is completely invalid. To make the point, more simply, the following is a hypothetical example, assuming for illustration only that apportionment should be on the basis of a property ratio (as was approved by this Court in *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271; and *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642):

Total sales (gross receipts)	$1,000,000
Total net income	100,000
Total property	1,000,000
Sales to Iowa Customers	100,000
Property in Iowa	10,000

Using the formula in the cited cases, and considering first apportioning entire net income:

Property ratio: $\frac{\$ \quad 10{,}000 \text{ Iowa}}{\$1{,}000{,}000 \text{ Total}} = 1\% \text{ Iowa}$

1% of $100,000 total income = $1,000

Considering next finding the total income from that segment of the business consisting of manufacturing and selling goods to Iowa customers:

Sales ratio: $\frac{\$ \ 100{,}000 \text{ Iowa}}{\$1{,}000{,}000 \text{ Total}} = 10\% \text{ Iowa}$

10% of $100,000 total income = $10,000 segment income

This is the *total* income from the segment of its business which results in sales to Iowa customers.

The sales ratio determines also the total property used to produce the goods in that segment:

10% of $1,000,000 total property = $100,000 segment property

Property ratio: $\frac{\$ \ 10{,}000 \text{ Iowa}}{\$100{,}000 \text{ Total segment}} = 10\% \text{ Iowa}$

10% of $10,000 segment income = $1,000

The above demonstration and especially the actual figures in the tabulation in Appendix E hereto, show why it is that the sales factor "apportions" nothing but merely identifies the income subject to apportionment—the income derived from the entire business of manufacturing without and selling into the taxing jurisdiction.

In *General Motors*, for the first time, this Court was faced with an apportionment formula that clearly was irrational. It responded to that situation by the use of, among other things, a hypothetical fact situation[8] to demonstrate the obvious—the single destination sales factor formula attributes to the taxing jurisdiction an excessive amount—100%—of the taxpayer's income in relation to the sources of income within the jurisdiction and the services rendered by that jurisdiction. This, very simply, is why that appeal and this one are not defeated, but rather buttressed, by the judicial approval of formulae applied in prior cases involving the single property factor and the three-factor formulae.

Based on the stipulation, the trial court found that for the fiscal year ending in 1968 the percentage of Moorman's payroll associated with its Illinois operations was 41% of its payroll everywhere; the Iowa payroll percentage was 15.63%. Of its property everywhere, that located in Illinois represented 84.29%, while that in Iowa was a mere 5.27%. Finally its sales in Iowa for that year were 21.88% of its sales everywhere (A. 76).

The trial court then observed (A. 76):

> "Yet in light of Moorman's relatively small property holdings and payroll contributions in Iowa (none of which are attributable to the manufacture of goods sold here), this State taxes 100 percent of in-state sales (21.88% of income for 1968), which are to a great degree attributable to Illinois plant and personnel inputs."

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8. 380 U.S. 553, 557. A corporation manufacturing entirely in Maryland and selling entirely in the District would have its entire income taxed in the District.

Moorman maintains that the foregoing irrefutably demonstrates that the effect of the Iowa formula is to tax income-producing activities occurring in Illinois in violation of the Due Process Clause of the Fourteenth Amendment and a fundamental principle of federalism.

Furthermore, it is undisputed that while the State of Iowa renders services to Moorman, it obviously does not render *all* the services which benefit Moorman's business of manufacturing in Illinois and selling in Iowa, and thus is not entitled to tax all the income arising from Moorman's sales in Iowa. The Iowa formula clearly fails to allow a reasonable apportionment of income associated with Iowa sales to be attributed to Illinois, which also provides benefits to Moorman with respect to such income. This failing of the Iowa formula to apportion tax in relation to benefits given clearly deprives Moorman of its property without due process of law.

The Iowa Supreme Court rejected the evidence of extra-territorial taxation set forth above as failing to be sufficient in either quantum or quality to satisfy the burden of proof imposed upon Moorman.

The Iowa statute, in prescribing a fraction the numerator of which is sales to Iowa customers and the denominator of which is sales everywhere, and applying that fraction to total net income rests on the assumption that every dollar of gross receipts (sales) relates to the same amount of net income as every other dollar of gross receipts. That assumption is, for this purpose, both economically and legally sound

That assumption necessarily includes the corollary assumption that costs (deductions) are similarly distributed —if they were not, the profit would vary from sale to sale. Thus, every dollar's worth of property makes the

same contribution to net income as every other dollar's worth of property and every dollar of payroll makes the same contribution to net income as every other dollar of payroll.

The figures establishing all three ratios are stipulated (A. 54). Therefore, the ability to calculate income attributable to Iowa is well-established by applying the assumptions to the stipulated figures in conformance with practice as to assumptions accepted by this Court in *Underwood; Bass, Ratcliff & Gretton; General Motors; all supra. Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942), and others.

The Iowa court seems to say that Moorman has not proved its case because it has not used separate accounting to establish its Iowa income. That method was held impermissible in the case of a unitary business and the foregoing assumptions were applied instead. *Butler Bros., supra.*

This Court has in the past declined to prescribe any specific formula for division of income. No such demand is made in this case, since the parties have stipulated that if the single-sales-factor is invalidated, they will apply the standard three-factor formula.

We do not want to be understood to urge proscription of the "destination sales" factor in a three-factor formula. To do so would be unreasonable. Clearly it could on constitutional grounds, be stopped as a penalty on imports. The result would be that taxpayers, such as Moorman, would have some of their income escaping tax altogether —a socially undesirable result. Moorman accepts the philosophy of this Court in *General Motors*: That the three-factor method is a "rough, practical" method of apportionment.

Finally, the Iowa court rejects this Court's reasoning in *General Motors* as having no bearing on this case for two reasons:

(1) That decision was statutory only, and

(2) The District of Columbia statute requiring that net income derived from a trade or business within and without the District shall "be deemed to be income from sources within and without the District" has "no analogue in the Iowa statute and can scarcely be found in the due process clause" (A. 130).

Moorman acknowledges that the *General Motors* decision of this Court was a statutory interpretation. Nevertheless, the statements of this Court outlining the inherent invalidity of a method of "apportionment" based on sales alone were a reiteration of constitutional principles of long standing. If *General Motors* truly was intended to reach "beyond the shores of the Potomac", the Iowa Court's view of that case is patently in error.

III. The Single "Destination Sales" Factor Denies Equal Protection.

The three major points: unconstitutional burden on interstate commerce; unconstitutional denial of due process, and unconstitutional violation of a basic principle of federalism—are sufficient. Nevertheless, we draw the Court's attention to the denial of equal protection which is inherent in Iowa's single "destination sales formula", particularly in relation to Illinois' (proper) three-factor formula. As this Court said in *General Motors,* after noting the double-taxation upon shipments *into* the District of Columbia:

"Conversely, in some cases enterprises will have their payroll and plant located in sales-factor jurisdictions and make their sales in three-factor jurisdictions so

that only 33% of their incomes will be subject to state taxation." (380 U.S. at 560).

That is what happens here: while Moorman is double-taxed on its income from sales to Iowa customers, its Iowa competitors are taxed on only one-third of their income from Illinois customers.

The denial of equal protection of the laws inherent in the Iowa formula can be readily demonstrated by a comparison of two hypothetical situations:

Situation 1: Corporation A manufactures all its products within the State of Iowa, but sells all of its products outside the State of Iowa.

Situation 2: Corporation B manufactures all of its products outside the State of Iowa, but sells all of its products within the State of Iowa.

Under the Iowa formula, the following pattern of taxation prevails:

Situation 1: None of the net income of Corporation A is taxable by the State of Iowa. This result is blatantly unfair. All of the property and people involved in manufacturing the product are located in Iowa, with only sales activity occurring outside the state. Yet despite the concentration of economic activity and the substantial rendition of services by the State of Iowa, Iowa collects no tax on A's income.

Situation 2: All of the net income of Corporation B is taxable by the State of Iowa. This result is as unreasonable as that in Situation 1. All of the productive factors of Corporation B are located outside Iowa and another state renders substantial services to B and its employees.

The foregoing hypothetical examples teach an unmistakable lesson: The Iowa formula penalizes out-of-state manufacturers and subsidizes Iowa-based firms which sell the bulk of their products outside the state.

It may appear to a casual observer that Section 422.33 (1), Code of Iowa, does operate uniformly upon all corporations engaged in the manufacture or sale of tangible personal property in the State of Iowa—the net income of all such corporations is "apportioned" to the state in the ratio that their sales in Iowa bears to their total sales. The above demonstration goes beyond appearances into the practical imposition of very different burdens on taxpayers whose situations should be treated equally. In the examination of a taxing statute, we must heed the warning of Mr. Justice Rutledge in *Nippert* v. *City of Richmond*, 327 U.S. 416, 431 (1946), in discussing one of the famous "drummer" statutes:

> "It is no answer, as appellee contends, that the tax is neither prohibitive nor discriminatory on the face of the ordinance; or that it applies to all local distributors doing business as appellant has done. Not the tax in a vacuum of words, but its practical consequences for the doing of interstate commerce in applications to concrete facts are our concern. To ignore the variations in effect which follow from the application of the tax, uniform on the face of the ordinance, to highly different fact situations is only to ignore those practical consequences. In that blindness lies the vice of the tax and of appellee's position."

The trial court found that Moorman's Commerce Clause and Due Process rights had been violated, but not its Equal Protection rights. That conclusion was based on a misunderstanding of Moorman's position: the court

justified a tax on "corporations" as a class distinct from other taxpayers. We agree, but our argument was that some members of the properly delineated class (corporations) may not be discriminated against as compared to other members of the same class. The Iowa legislature has created a valid classification of "corporations" which Section 422.33 purports to treat throughout in like manner, without discrimination as to location. But, as shown above, this purported equal treatment is illusory.

The trial court's reasoning, adopted by the Supreme Court of Iowa, is devoted to discussion of classification, citing *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973) for the proposition that corporations may be taxed differently from individuals. There is no such issue.

IV. Application of the Single "Destination Sales" Factor to Moorman Is Unconstitutional.

Earlier portions of this brief have dealt with the issue of whether the single sales factor method of assigning corporate income to Iowa contained in Section 422.33(1)(b), Code of Iowa, is unconstitutional on its face under the due process, commerce clause and equal protection provisions of the Constitution and tramples on an important principle of federalism.

In finding that this formula is unconstitutional on its face under the due process and commerce clauses, the trial court did not feel it had to consider whether such method was unconstitutional in its *application* to Moorman. That Court merely analyzed the Moorman figures to substantiate that the hypothesis of this Court in *General Motors* v. *District of Columbia, supra*, was correct—multiple taxation does occur under the Iowa system of taxation.

The Supreme Court of Iowa, however, reversed the trial court's holding that the Iowa formula was unconstitu-

tional on its face. As to the issue of its constitutionality as applied to Moorman, the court found that Moorman had failed to carry its burden of proof because it had not proved that it is "dissimilar from the typical unitary business organization." (A. 139). Moorman had not sought any such distinction and, in fact, claims to be "a typical unitary business organization."

A determination of the constitutionality of the Iowa method as it applies to Moorman necessitates an analysis of Moorman's particular situation. The parties stipulated a substantial amount of statistical information concerning Moorman during the years at issue. This information has been analyzed in earlier portions of this brief in great detail. These data demonstrate beyond question that the State of Iowa is taxing income partially created in Illinois, is causing actual, substantial multiple taxation to be visited upon Moorman and is placing a burden upon Moorman's interstate activities, as the trial court found.

Nowhere in its opinion does the Iowa court refute these unassailable conclusions derived from the stipulated statistical data. Yet the Iowa court finds that Moorman has failed in meeting its burden of proof in this area. Moorman asserts (and the Iowa court agreed) that by reason of the very nature of a unitary business it is impossible to assign each item of income and expense on a state-by-state basis. Indeed, the Iowa statute requires only that *net* income be apportioned. Moorman has placed in evidence via the stipulation sufficient relevant information to demonstrate the presence of the evils arising for the Iowa apportionment formula catalogued above.

It is submitted that if there is indeed *any* type or quantum of evidence sufficient to carry a taxpayer's burden of proof in this type of case, Moorman has more than fulfilled the requirements. As noted in the Iowa

court's decision (A. 119), the state must come forward with evidence to counter that provided by Moorman. This the state has failed to do.

Whether Moorman is in a situation similar or dissimilar to other corporations is immaterial when the issue is constitutionality in *application*, for all that need be shown is that the State of Iowa is levying a tax on a greater portion of Moorman's net income arising from Iowa sales than is permissible under the federal Constitution.

V. Affirmance of the Iowa Decision Would Be a Serious Detriment to the American Common Market.

> "In any case, the sheer inconsistency of the District formula with that generally prevailing may tend to result in the unhealthy fragmentation of enterprise and an uneconomic pattern of plant location . . ."—*General Motors, supra* at 560.

There is a strong incentive for each state, acting by itself, to violate the basic concept of federalism—the common market—to its own shortsighted benefit. Thus, and not unnaturally, the Supreme Court of Iowa gave far greater consideration to the briefs extolling Iowa's destination sales formula than it did to either Moorman's logical exposition of the law or the splendid analysis by the trial judge.

As the fifteen economists (William J. Baumol, *et al.*), said in their brief *amicus curiae* urging the Court to accept this appeal:

> "One of the most important ways in which competition controls economic activity is to create pressures to eliminate higher cost producers. When these higher costs are due to inefficient management or inefficient production techniques, this pressure to eliminate cer-

tain firms or force them to perform more efficiently is unequivocally socially desirable. However, competition will have this excluding effect regardless of the particular cause of higher costs. Thus the effects of a differentially higher tax rate will be precisely the same on a firm in a competitive industry as will a poor management policy that 'costs' the same amount. But in the tax case competition is actually prevented from performing the socially useful function of eliminating undesirable economic inefficiencies. And this is exactly the effect of the Iowa 'single factor' tax formula when adopted in the face of the otherwise universal use of a three-factor attribution test." (Page 2 of their brief).

Note how well that economic exposition explains the basis for our Equal Protection argument, and how strongly it supports what this Court said in *General Motors*, quoted at p. 37 *supra*.

As previously stated, the purpose and effect of the "destination sales" factor is to subsidize exports and impose a tariff on imports. If it is given only one-third weight it can be tolerated in the context of the almost universal use of the equally weighted three-factor formula. But if Iowa can succeed in its present effort, other jurisdictions will surely follow—selfish and shortsighted pressures from local businesses will be irresistible. Again quoting the economists *amici*:

> "As political pressures build in one state and then another to secure these hidden competitive benefits for domestic businesses through selection of appropriate tax formulas, the spector of a severely damaging, yet not openly declared trade war between states begins to threaten. No conceivable economic advantage

> could justify the economic costs attendant upon such conflict." (Page 7 of their brief).

Perhaps discouraged by this Court's decision in *General Motors, supra*, no state but Iowa has attempted the gross discrimination against interstate commerce which is inherent in the single "destination sales" factor. Several others are, however, inching up on it through double-weighting the sales factor: Florida, 1971; Wisconsin, 1975; New York, 1976; Massachusetts, 1977. Is there any doubt they will move from double-weight to 100% weight if Iowa can do it?

States and communities tend to welcome industrial establishments, partly to create jobs and even more to acquire tax base. Many of them put on elaborate promotions, and some offer special inducements: Using the local government's ability to offer tax-free interest to bond buyers; property tax exemptions for limited periods. The Iowa device of handicapping out-of-state producers while bonusing local business is an inducement to "an uneconomic pattern of plant location".

Again quoting the economists:

> "Thus the Iowa tax based on sales revenue for an Illinois corporation producing in Illinois in effect becomes a tax on property and payrolls in Illinois. But these items are already taxed in Illinois via the three-factor formula. . . Regardless of the intention of the framers of the Iowa tax the effect is clearly contrary to the principle of federalism that underlies the Commerce Clause of the United States Constitution. The necessary effect of this tax is precisely the same as an Iowa tariff imposed on Illinois or other corporations doing business in Iowa in competition with Iowa companies. To allow this state of affairs to persist in any

state is to invite, indeed even to force, retaliation by other states. . . It is of utmost importance that this Court address itself once again to this issue and prevent the development of debilitating internal conflict in the United States." (Page 7 of their brief).

Boston Stock Exchange v. *State Tax Commission, supra*:

". . . the fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States."

CONCLUSION

As we said in our Jurisdictional Statement, and has been emphasized by the briefs *amicus curiae*, such taxpayer representatives as the Motor Vehicle Manufacturers Association and the Council of State Chambers of Commerce, the broad spectrum of academic economists, and even the Multistate Tax Commission, the organized state tax administrators (they didn't say it just that way): the decision of this Court is needed to halt the effort of Iowa to shift its tax burden to foreigners and remove the temptation for other states to do likewise.

The Iowa single "destination sales" formula is so incompatible with the three-factor formula used by Illinois and most other states that it cannot be allowed to survive.

It unduly burdens interstate commerce by imposing double taxation.

It violates due process and, even more importantly, the fundamentals of federalism, by taxing values not within its jurisdiction.

It denies equal protection by giving advantages to domestic producers which it denies to foreign producers.

Its survival would seriously disrupt our United States common market.

For the reasons stated, it is submitted that the decision of the Supreme Court of Iowa should be reversed and the single sales factor for division of income for tax purposes in the Iowa statute be declared unconstitutional.

Respectfully submitted,

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APPENDIX

APPENDIX A

CONSTITUTION OF THE UNITED STATES

ARTICLE I.

* * *

Section 8. The Congress shall have Power. . .

* * *

To regulate Commerce . . . among the several States. . .;

AMENDMENT 14.

Section 1. * * *; nor shall any State deprive any person of . . . property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

APPENDIX B

CODE OF IOWA

422.33 Corporate tax imposed

A tax is hereby imposed upon each corporation organized under the laws of this state, and upon every foreign corporation doing business in this state, annually in an amount equivalent to four percent of the net income received by such corporation during the income year.

1. If the trade or business of the corporation is carried on entirely within the state, the tax shall be imposed on the entire net income, but if such trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net

income reasonably attributable to the trade or business within the state, said net income attributable to the state to be determined as follows:

a. Interest, dividends, rents and royalties (less related expenses) received in connection with business in the state shall be allocated to the state, and where received in connection with business outside the state, shall be allocated outside of the state.

b. Net income of the above class having been separately allocated and deducted as above provided, the remainder of the net income of the taxpayer shall be allocated and apportioned as follows:

* * *

Where income is derived from the manufacture or sale of tangible personal property, the part thereof attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales.

The gross sales of the corporation within the state shall be taken to be the gross sales from goods sold and delivered within the state, excluding deliveries for transportation out of the state.

For the purpose of this section, the word "sale" shall include exchange, and the word "manufacture" shall include the extraction and recovery of natural resources and all processes of fabricating and curing. The words "tangible personal property" shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares, and merchandise, and shall not be taken to mean money deposits in banks, shares of stock, bonds, notes, credits, or evidence of an interest in property and evidences of debt.

2. If any taxpayer believes that the method of allocation and apportionment hereinbefore prescribed, as administered by the commission and applied to his business, has operated or will so operate as to subject him to taxation on a greater portion of his net income than is reasonably attributable to business or sources within the state, he shall be entitled to file with the commission a statement of his objections and of such alternative method of allocation and apportionment as he believes to be proper under the circumstances with such detail and proof and within such time as the commission may reasonably prescribe; and if the commission shall conclude that the method of allocation and apportionment theretofore employed is in fact inapplicable and inequitable, it shall redetermine the taxable income by such other method of allocation and apportionment as seems best calculated to assign to the state for taxation the portion of the income reasonably attributable to business and sources within the state, not exceeding, however, the amount which would be arrived at by application of the statutory rules for apportionment.

(Note: The foregoing Section 422.33, Code of Iowa, is as it appears at Vol. II, p. 1669 of the 1966 edition of the Code; it has been amended subsequently in respects not material to this case and appears in its latest form in Code of Iowa (1977), Vol. II, p. 2078.)

422.35 Net income of corporation—how computed.

The term "net income" means the taxable income less the net operating loss deduction, both as properly computed for federal income tax purposes under the Internal Revenue Code of 1954, with the following adjustments:

1. Subtract interest and dividends from federal securities.

2. Add interest and dividends from foreign securities and from securities of state and other political subdivisions exempt from federal income tax under the Internal Revenue Code of 1954.

3. Where the net income includes capital gains or losses, or gains or losses from property other than capital assets, and such gains or losses have been determined by using a basis established prior to January 1, 1934, an adjustment may be made, under rules and regulations prescribed by the state tax commission, to reflect the difference resulting from the use of a basis of cost or January 1, 1934, fair market value, less depreciation allowed or allowable, whichever is higher. Provided that the basis shall be fair market value as of January 1, 1955, less depreciation allowed or allowable in the case of property acquired prior to that date if use of a prior basis is declared to be invalid.

4. Subtract federal income taxes paid or accrued, as the case may be, during the tax year, adjusted by any federal income tax refunds; and add the Iowa income tax deducted in computing said taxable income.

5. Add the amount by which the basis of qualified depreciable property is required to be increased for depreciation purposes under the Internal Revenue Code Amendments Act of 1964 to the extent that such amount equals the net amount of the special deduction allowed on the basis of the amount by which the depreciable basis of such qualified property was required to be reduced for depreciation purposes under the Internal Revenue Code Amendments Act of 1962. The "net amount of the special deduction" shall be computed by taking the sum of the amounts by which the basis of qualified property was required to be decreased for depreciation purposes for the years 1962 and 1963 and subtracting from it the sum

of the amounts by which the basis of such property was required to be increased, prior to 1964, for depreciation or disposition purposes under the Internal Revenue Code Amendments Act of 1962.

Provided, however, that a corporation affected by the allocation provisions of section 422.33 shall be permitted to deduct only such portion of the deductions for net operating loss and federal income taxes as is fairly and equitably allocable to Iowa, under rules and regulations prescribed by the state tax commission.

(Note: The foregoing Section 422.35, Code of Iowa, is as it appears at Vol. II, p. 1670 of the 1966 edition of the Code; with respect to taxable years beginning on or after January 1, 1967, Subsection 4 was amended by inserting "fifty (50) per cent of the" preceding the words "federal income taxes", Acts of 1967 (62 G.A.) ch. 348, §17. The latest form of Section 422.35 appears in Code of Iowa (1977), Vol. II, p. 2080.)

APPENDIX C

The Illinois Income Tax Act, 120 Ill. Rev. Stat. §3-304 provides as follows:

§3-304. Business income of persons other than residents

(a) In general. The business income of a person other than a resident shall be allocated to this State if such person's business income is derived solely from this State. If a person other than a resident derives business income from this State and one or more other states, then, except as otherwise provided by this Section, such person's business income shall be appor-

tioned to this State by multiplying the income by a fraction, the numerator of which is the sum of the property factor (if any), the payroll factor (if any) and the sales factor (if any), and the denominator of which is 3 reduced by the number of factors which have a denominator of zero. * * *

APPENDIX D

The Uniform Division of Income for Tax Purposes Act provides as follows:

§3. For purposes of allocation and apportionment of income under this Act, a taxpayer is taxable in another state if (1) in that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

§9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

APPENDIX E

COMPARATIVE COMPUTATION OF APPORTIONMENT

Usual computation of net income, and the computations of Moorman's tax returns under the apportionment formula which it used, are shorthand computations which produce accurate results but which tend to obscure what is being

done. Working them in longhand helps to clarify. The Iowa statute starts the computation of taxable income with federal taxable income, which is determined by subtracting from gross receipts the expenses and other deductions attributable thereto, with certain adjustments. (Code of Iowa, Chapter 422). We know the amounts of total gross receipts and the part thereof derived from sales to Iowa customers. Applying that ratio to the known total expenses and other deductions, we determine the deductions allocable to Iowa receipts. Thus, for 1968 (figures for convenience are in thousands of dollars and rounded):

	Longhand Method	Shorthand Method
(a) Iowa Receipts	21,380	21,380
(b) Total Receipts	97,720	97,720
(c) Total Deductions	90,643	
(d) Total Income		7,077
(e) Segment Deduction (a÷b) X c	19,832	
(f) Segment Income a – e	1,548	
(g) Segment Income (a÷b) x d		1,548

Either method arrives at the same amount of net income derived from the segment of the business carried on both within and without Iowa. That is the amount which is to be apportioned. Again, the apportionment can be done either longhand (for clarity) or shorthand (for convenience).

Here we illustrate both, again with 1968 figures, on the principle enumerated by this Court, that "payroll"

and "property" fractions are sound measures of relative business activity:

		Longhand Method	Shorthand Method
(a)	Iowa Receipts	21,380	
(b)	Total Receipts	97,729	
(d)	Total Income		7,077
(f)	Segment Income	1,548	
(h)	Iowa Payroll	3,739	3,739
(i)	Total Payroll	23,919	23,919
(j)	Segment Payroll (a÷b) X i	5,233	
(k)	Iowa Property	1,133	1,133
(l)	Total Property	21,501	21,501
(m)	Segment Property (a÷b) X l	4,704	
(n)	Iowa Income $\frac{(h\div j) + (k\div m) \text{ X } f}{2}$	739	
(o)	Iowa Income $\frac{(h\div i) + (k\div l) \text{ X } d}{2}$		739

Longhand or shorthand, the result is the same; but the longhand method shows more clearly the illogic of using a sales factor, either alone or in conjunction with other factors, for "apportionment" purposes. When the ratio of gross receipts has been applied to determine the amount of net income attributable to the selected segment, it has exhausted its function and cannot validly be used

again to divide up that income. Nevertheless, there are practical reasons for a three-factor formula, including sales, as this Court noted in *General Motors*. That feature can be added to the tabulation as follows:

		Longhand Method	Shorthand Method
(p)	Iowa Income $\frac{(\ (h\div j) + (k\div m) \text{ X } f)+f}{3}$	$1,008	
(q)	Iowa Income $\frac{(h\div i) + (k\div l) + (a\div b) \text{ X } d}{3}$		$1,008

The longhand method clearly reveals the duplication in the treatment of income; that is, using the income—f—to apportion itself. The effect is arbitrarily to assign or allocate one-third of the apportionable income to Iowa and then to apportion the remaining two-thirds. The identical principle is involved in, and the identical result achieved by, the shorthand method. This last is the one used in Moorman's returns, and which has been stipulated to be the method to be used if this Court finds the single destination sales factor constitutionally unacceptable. (The above figures are based on the Director's findings of segment income, etc. and differ from those in the return —but the method is identical.)